MOBIL OIL CORP.

IBLA 87-780 Decided December 13, 1989

Appeal from a decision by the Director, Minerals Management Service, affirming orders requiring payment of additional royalties and late payment charges. MMS-86-0297-OCS, MMS-86-0432-OCS.

Set aside and remanded.

1. Federal Oil and Gas Royalty Management Act of 1982: Royalties--Oil and Gas Leases: Royalties: Natural Gas Liquid Products--Outer Continental Shelf Lands Act: Oil and Gas Leases

   Where the low posted spot market price for the month for natural gas liquid products is found by MMS to establish the fair market value floor for royalty valuation, a decision assessing additional royalty charges based on the difference between lessee's reported valuation and the average spot market price will be set aside and remanded.

2. Oil and Gas Leases: Royalties: Generally--Payments: Generally

   Transportation costs unrelated to the manufacturing process are not properly included in the formulation of a manufacturing allowance to be used in calculating the royalty value of natural gas liquid products.

3. Oil and Gas Leases: Royalties: Generally--Payments: Generally

   When formulating a manufacturing allowance for purposes of calculating royalty, an allowance for expenses incidental to marketing ethane gas was properly denied. When calculating royalty pursuant to 30 CFR 206.150 (1986), the value of production shall not be less than fair market value, nor less than gross proceeds accruing from disposition of produced gas.

APPEARANCES: W. R. Buck, Esq., Dallas, Texas, for appellants; Peter J. Schaumberg, Esq., Geoffrey Heath, Esq., Howard W. Chalker, Esq., Office of the Solicitor, United States Department of the Interior, Washington, D.C., for Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE KELLY

Mobil Oil Corporation (Mobil) has appealed from a July 13, 1987, decision of the Director, Minerals Management Service (MMS), affirming orders of the Regional Manager, Tulsa Regional Compliance Office (TRCO), MMS, dated May 1, 1986, requiring payment of additional royalties for natural gas liquid products (NGLP) for two of Mobil's Outer Continental Shelf (OCS) leases (OCS-G-2866 and OCS-G-775), and dated July 22, 1986, assessing late payment charges for these same leases.

The record shows that Mobil is the operator and 50-percent owner of the Cow Island Gas Processing Plant and the Riverside fractionator in Louisiana (Cow Island Complex). Mobil's share of natural gas produced from the two OCS leases in question is processed through the Cow Island Complex.

When a lessee has its gas processed for the recovery of constituent products, it must pay royalty on the higher value of (1) wet gas before processing or (2) residue gas after processing plus extracted liquids, which may be reduced by a manufacturing allowance not to exceed two-thirds of the extracted liquids (30 CFR 206.152). Where, as in this case the lessee has an ownership interest in the processing plant, the "manufacturing allowance" is figured, usually for a biennial period, by MMS based on financial data submitted by all plant owners. The resulting allowance is subject to audit. In this case, the manufacturing allowance originally approved for the Cow Island Complex was based on financial data submitted by all plant owners.

The Office of Inspector General (OIG), U.S. Department of the Interior, audited the financial data supporting the Cow Island manufacturing allowances. The audit covered the period May 1978 through December 1983 and included a review of two biennial reporting periods (May 1, 1978 - April 30, 1980, and May 1, 1980 - April 30, 1982). In its audit report to the Assistant Secretary, Land and Minerals Management, OIG presented its preliminary audit findings and a number of recommendations for MMS. MMS analyzed and finalized the audit findings, concluding that adjustments to the previously authorized manufacturing allowances and adjustments in the royalty base values used for some extracted liquids were required. MMS acted on these findings ordering Mobil to recalculate royalties on its two leases that supply gas to Cow Island for processing.

In a decision letter of May 1, 1986, following review of Mobil's royalty payments from May 1978 through December 1983, for leases OCS-G-2866 and OCS-G-775, the Regional Manager, TRCO, MMS, ordered Mobil to recalcu-late and pay additional royalties to reflect adjustments to expenses and revenues from the Cow Island Gas Complex arising from audit-revised com-putation of the manufacturing allowances and liquid product valuations for liquids extracted from gas.

The Regional Manager based his decision primarily on royalty valuation procedures set out in the "Procedure Paper on Natural Gas Liquid Products Valuation" (Procedure Paper) issued by the Royalty Valuation and Standards Division of the Royalty Compliance Division of MMS on December 14, 1984, and revised on February 25, 1985. The Procedure Paper was developed in response to the problems encountered by MMS in establishing an appropriate method of valuing NGLP extracted from gas produced from Federal leases, especially where the NGLP had been used internally. Because the regulations require MMS to establish a basis for royalty using a reasonable unit value which should never be less than the fair market value, see 30 CFR 206.150 (1987), the Procedure Paper's stated purpose was to develop a "yardstick" valuation technique for determining the reasonableness of a lessee's NGLP prices (Procedure Paper at 3). In applying this yardstick, MMS distin-guished between sales situations in which an arm's-length contract existed and those with non-arm's-length contracts or no contract.

In determining the appropriate yardstick, MMS considered several factors, including NGLP sales contracts, the prices received by lessees, regulated prices, and commercially available NGLP bulletins. Based on an evaluation of these sources, MMS concluded that commercial price bulletins represented the best available price source, and in most instances were indicative of NGLP fair market value (Procedure Paper at 5). The Procedure Paper explained the royalty valuation methodology set forth therein as follows:

> To establish a yardstick to compare to the lessee's reported prices, MMS will take the highest and lowest published prices for the month from the appropriate bulletin. If the reported price falls within this range, the value will normally be accepted by MMS for royalty determination purposes.
>
> *   *   *   *   *   *   *
>
> If the prices used to calculate royalties fall below this range, a minimum value that is acceptable to MMS can be deter-mined by developing an average from the lowest and highest prices in the range.

Id. at 6, 7. The Procedure Paper also listed suggested spot price locations for various producing areas and the appropriate bulletins to be used as price sources. For the NGLP at issue in this case, Mont Belvieu, Texas, was the suggested market.

In light to these procedures, MMS ordered Mobil to adjust the unit prices in accordance with the published spot price at Mont Belvieu, i.e., to recompute the royalty owed using the average of the applicable highest and lowest published prices explaining:

> During the period May 1978 through December 1983, Mobil based its NGLP royalty prices on both intracompany transfer prices and arm's-length sales transactions. Our review disclosed that royalties may have been understated on OCS leases G-2866 and G-775 as a result of valuing various products at less than either arm's-length invoice prices or the lowest Mont Belvieu spot prices.
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> * * * * * * *
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> For determining the reasonableness of the NGLP values for royalty purposes, the MMS policy is to apply procedures as set out in its "Procedure Paper on Natural Gas Liquid Products Valuation." The procedures provide that if the NGLP's were disposed under non-arm's-length transactions, including transfers to affiliates, the unit values will be compared to the lowest price published in commercial bulletins. If the value falls below the low price, it is considered unreasonable and unacceptable and an average value is calculated for use.
>
> For certain NGLP's during the period January 1980 through December 1983, the intracompany transfer price used on the 250.67 worksheet for royalty calculations was less than the lowest published spot prices at Mont Belvieu.

(Decision Letter at 4, 5).

The Regional Manager specifically rejected Mobil's claimed credit for certain expenses as manufacturing allowances explaining:

> "Income on Gross Liquids" should include 100% of the value of the plant owner's share of natural gas liquid products (NGLP's) produced by the Cow Island Gas Processing Plant (Cow Island). This value would include the value of all liquids processed by the plant, whether from plant owner gas or non-plant owner gas. The value of each NGLP volume produced is based on its respective average unit price derived from plant-owner sales.

(Decision Letter at 1). As to Mobil's Expenses and Depreciation he explained:

> Allowable Cow Island costs should include expenses and depreciation directly related to or associated with the pro-cessing of natural gas liquids. The cost of processing should only include Cow Island's pro rata share of the costs associated with the Riverside Fractionation Plant (Riverside). Such expenditure should be limited to those items which are an integral part

> of the extraction process. Therefore all costs associated with the delivery, storage and disposal of the residue gas and liquids after extraction should be excluded.
>
> The MMS review disclosed that costs at certain Riverside facilities are not related to or associated with the extraction process, but rather, are associated with the delivery or storage of liquids after extraction. Accordingly, expenses and depreci-ation associated with the following Riverside facilities were either totally or partially disallowed.

(Decision letter at 2). Citing 30 CFR 206.152 which provides that a reasonable allowance may be made for the cost of processing and may be deducted from royalty payments, MMS determined Mobil had used excessive manufacturing allowances on its worksheets from which royalties on two Federal leases were computed and royalties on these leases may have been understated during the period May 1978 through April 1982 (Decision Letter at 4).

Acting in compliance with this order, Mobil paid additional royalties of $421,086.01, and filed administrative appeal MMS-86-0297-OCS with the Director, MMS. Subsequently, On July 22, 1986, Mobil was assessed late payment charges of $383,158.43 in connection with the additional royalty payment which it had made. Mobil appealed from this assessment in admin-istrative appeal MMS-86-0432-OCS.

Mobil's appeals were consolidated for consideration by the Director, MMS, who, on July 13, 1987, denied Mobil's appeals, affirming the assess-ments made by the Regional Compliance Office. The Director reaffirmed the guidelines of valuation set forth in the Procedure Paper finding that the Compliance Office had properly exercised its discretion under the Outer Continental Shelf Lands Act (OCSLA), as amended, 43 U.S.C. §§ 1331-1356 (1982), the regulations promulgated thereunder, and the leases involved when it assessed the challenged deficiency based on the yardstick values. Further, the Director found that Mobil had not met its burden of estab-lishing that the methodology used was, in fact, erroneous by arguing that there is another reasonable value for production. Although Mobil had stated that the prices upon which royalties were based during the audit period were fair and equitable, the Director found that Mobil had not submitted documentary evidence to support this claim (Director's Decision at 4, 5).

On appeal to this Board from the Director's decision, Mobil does not challenge the authority of MMS to make late payment charges, although it does deny the validity of the underlying assessments. It is well estab-lished that MMS has the authority to assess late payment charges when such charges represent the interest lost by virtue of the late payment of royal-ties. 30 CFR 250.49 (1980); Sun Exploration & Production Co., 104 IBLA 178, 186-87 (1988); Amoco Production Co., 78 IBLA 93, 100 (1983), aff'd, Amoco Production Co. v. Hodel, 627 F. Supp. 1375 (W.D. La. 1986), vacated and remanded, 815 F.2d 325 (5th Cir. 1987), cert. denied, 56 U.S.L.W. 3891 (U.S. June 28, 1988).

Mobil asserts in its statement of reasons (SOR) that its approach to valuation is reasonable, satisfies all statutory and regulatory require-ments and is consistent with the procedures outlined in the Procedure Paper. Mobil argues that the Procedure Paper contemplates that the yardstick value is to be used only if there is insufficient evidence of market value based upon arm's-length contracts. Mobil asserts that MMS reliance on the yardstick price is arbitrary and capricious because evidence of market value was made available in that their non-arm's-length contracts have characteristics similar to arm's-length contracts (SOR at 9).

Mobil asserts that the yardstick approach is not applicable to this situation and is "fatally flawed and outside the authority of the Secretary of the Interior" (SOR at 10). It points out that the procedure of asses-sing royalties on an average between the highest and lowest published prices where the lessee's reported price falls below this range is arbitrary and capricious. Mobil argues that when its price falls below the lowest spot price it is penalized when it is forced to pay the higher average price, stating:

> At a minimum, it encourages lessees to value their products for royalty purposes at least one cent above the lowest price in all cases where their price falls below the minimum * * *. Clearly, if the MMS will accept the lowest price in the range, that price should be used when the lessee receives less than that amount.

(SOR at 11-12).

Mobil also argues that the spot market prices at Mont Belvieu, Texas, are unreasonable measures of the value of NGLP's sold at the plant in Louisiana over 300 miles away and MMS makes no adjustment for costs of transporting the product to the Texas location.

MMS has responded that its valuation of Mobil's NGLP was proper in that it merely was applying the Procedure Paper as guidance to determine if Mobil's royalty valuations were reasonable and consistent with the requirements of the leasing statute, the regulations and the lease terms. After considering all the factors, "It then determined that Mobil's prices used for royalty valuation were less than fair market value and that posted spot prices give the best indication of the market or reasonable value of Mobil's NGLP" (Answer at 6). MMS further contends that Mobil has failed to meet its burden of establishing that MMS's methodology is erroneous.

MMS asserts that the selection of the average spot price as royalty value does not penalize the lessee because prices which fall below the lowest spot price are unreasonable and less than fair market value. MMS points out the regulations and the lease give the Director the authority to establish fair market value and Mobil has not shown that it was erroneous to choose an average spot price from the Mont Belvieu market for royalty value for the Cow Island Complex.

The OCSLA, as amended, 43 U.S.C. §§ 1331-1356 (1982), and provisions of appellant's lease issued pursuant thereto, require the payment of a royalty on production of oil and gas based on a specified percentage of the amount or value of the oil and gas produced. The Act requires that royalty be paid in the amount of the fair market value of the oil and gas produced from an OCS lease. Watt v. Energy Action Educational Foundation, 454 U.S. 151, 162 (1981); Sun Exploration & Production Co., supra; Amoco Production Co., supra.

It is well established that the Secretary has considerable discretion in determining the value of production for royalty purposes. Marathon Oil Co. v. United States, 604 F. Supp. 1375, 1382 (D. Alaska 1985), aff'd, 807 F.2d 759 (9th Cir. 1986), cert. denied, 107 S. Ct. 1593 (1987); Texaco, Inc., 104 IBLA 304, 308 (1988); Amoco Production Co., supra at 96.

The determination of appellant's royalties in this case was governed by the provisions of the royalty valuation regulation at 30 CFR 206.150 (1987), formerly 30 CFR 250.64 (1979). 1/ That regulation states:

> The value of production shall never be less than the fair market value. The value used in the computation of royalty shall be determined by the Director. In establishing the value, the Director shall consider: (a) The highest price paid for a part or for a majority of like-quality products produced from the field or area; (b) the price received by the lessee; (c) posted prices; (d) regulated prices; and (e) other relevant matters. Under no circumstances shall the value of production be less than the gross proceeds accruing to the lessee from the disposi-tion of the produced substances or less than the value computed on the reasonable unit value established by the Secretary.

1/ Effective Mar. 1, 1988, the Department completely revised the regulations in 30 CFR relating to gas valuation for royalty purposes. 53 FR 1230 (Jan. 15, 1988). The new regulation for processed gas, 30 CFR 206.153, provides that valuation for royalty purposes is to be determined based upon the combined value of the residue gas and all gas plant products, less certain allowances. When the residue gas or any gas plant product is not sold pursuant to an arm's-length contract, the regulation provides that value will be determined in accordance with the first applicable benchmark method listed. These methods include: (1) the gross proceeds accruing from a sale pursuant to a non-arm's-length contract which is comparable to an arm's-length contract; (2) values determined by consideration of other information relevant in valuing like-quality gas or products including proceeds from arm's-length contracts, posted prices, spot prices, and other reliable public sources of price or market information, and other information particular to the individual lease; and (3) a net-back method or any other reasonable method to determine value. 30 CFR 206.153(c), 53 FR at 1276. References in this decision are to gas regulations in effect during the relevant periods in dispute unless otherwise noted.

Further, valuation for royalty purposes of natural gas from which NGLP are produced was also guided by the regulation at 30 CFR 206.152 (1987), formerly 30 CFR 250.67 (1979), which provides, in relevant part:

> (a) When gas is processed for the recovery of constituent products, a royalty established by the terms of the lease will accrue on the value or amount of:
>
> (1) All residue gas remaining after processing, and
>
> (2) All natural gasoline, butane, propane, or other substances extracted from the gas. * * *
>
> (b) Under no circumstances shall the amount of royalty on the residue gas and extracted substances be less than the amount which the Director determines would be payable if the gas had been sold without processing.

The record also shows that the standard Federal offshore lease con-tains similar language as to royalty valuation as follows:

> It is expressly agreed that the Secretary may establish minimum values for purposes of computing royalty on products obtained from this lease, due consideration being given to the highest price paid for a part or for a majority of production of like quality in the same field, or area, to the price received by the Lessee, to posted prices, and to other relevant matters.

In the present case, Mobil reported both intracompany transfer prices and arm's-length sales for certain periods under review at prices MMS determined to be less than fair market value in light of the various factors set out in the law, the regulations and the leases. The Depart-ment, in exercising its discretion in valuing production for royalty purposes, is not bound by contract prices reported by the lessee where it is determined that minerals are being sold at less than reasonable value because the Government must receive fair market value. Texaco, Inc., supra at 310.

Nevertheless, in accordance with the Procedure Paper, the price received under a true arm's-length contract establishing an NGLP price will normally be accepted by MMS for royalty purposes. Similarly, if a lessee has a non-arm's-length contract which established an NGLP price and the lessee can show that the contract has characteristics similar to arm's-length contracts which represent fair market value, MMS will normally accept the non-arm's-length contract price for royalty valuation purposes.

Mobil argues that MMS resorted to spot prices in this case without giving proper consideration to its non-arm's length contracts which, it asserts, had terms similar to arm's-length contracts which represented fair market value. Mobil asserts that arm's-length contracts relating to the same field "were fully accessible to the OIG auditors and to the MMS at any and all pertinent times" (SOR at 7). None of those contracts is part of the record before this Board.

However, based upon a statement made by MMS in its May 1, 1986, order requiring additional royalties, it appears that MMS did not consider whether Mobil's non-arm's-length contract prices satisfied Procedure Paper requirements. In the order, MMS stated:

> For determining the reasonableness of the NGLP values for royalty purposes, the MMS policy is to apply procedures as set out in its "Procedure Paper on Natural Gas Liquid Products Valuation." The procedures provide that if the NGLP's were disposed of under non-arm's-length transactions, including transfers to affiliates, the unit values will be compared to the lowest price published in commercial bulletins. If the value fails below the low price, it is considered unreasonable and unacceptable and an average value is calculated for use. [Emphasis added.]

(SOR, Exh. 1 at 5).

That statement indicates that the guidelines of the Procedure Paper were not followed by MMS in this case. In Amoco Production Co., 112 IBLA 77, 81 (1989), we summarized the valuation procedure adopted by MMS in the Procedure Paper, as follows:

> [The Procedure Paper] provides guidance by specifying which of the factors listed in 30 CFR 250.64 (1982) is to be given the most weight in various circumstances. Where there is a regulated price, that price will be accepted for royalty computation purposes. Where there is an arm's-length contract or a non-arm's-length contract with characteristics similar to arm's-length contracts which represent fair market value, MMS normally will accept the contract price, unless gross proceeds are higher. In the event that prices are not controlled and there is neither an arm's-length contract nor a non-arm's-length contract with characteristics similar to arm's-length contracts which represent fair market value, the price received by the lessee will still be given the most weight, unless it falls below the yardstick range established by the commercial price bulletins. Under those cir-cumstances, the average of the prices in the commercial bulletins will be the minimum acceptable value.

In this case, MMS apparently turned to spot prices without evaluat-ing whether or not Mobil's non-arm's-length contracts had characteristics similar to arm's-length contracts in the same field or area which repre-sented fair market value. Under the circumstances, and since this case is being remanded on other grounds discussed infra, it is appropriate for MMS, on remand, to review any information presented by Mobil relating to the question of whether Mobil's non-arm's-length contracts had characteristics similar to arm's-length contracts in the same field or area which represented fair market value. See Mobil Oil Corp., 112 IBLA 56, 64 (1989).

Assuming for purposes of further review of this appeal that Mobil's contract prices did not represent fair market value, utilization of Mont Belvieu spot market prices was proper. See Conoco, Inc., 110 IBLA 232, 241 (1989). Mobil alleges that the Cow Island area and Mont Belvieu are geographically and economically distinct and that transportation costs from the Cow Island Complex to Mont Belvieu must be considered in the valuation process. This argument must be rejected. Mobil has provided nothing to substantiate substantial price differentials in these areas or that products would have to be transported any further to Mont Belvieu than the nearest potential market. Id. at 242.

[1] However, although we have approved the use of the Mont Belvieu spot price as a controlling relevant factor in valuing NGLP production, we must agree with Mobil in its criticism of the manner in which this spot market price is used to value production when the lessee's price falls below the yardstick floor price. We specifically discussed this qualification in Conoco where we stated:

> The Procedure Paper provides that if the lessee's reported price falls within the range of the high and low spot market prices for the month, the value will normally be accepted for royalty determination purposes. Thus, in effect, the lowest posted spot market price of the month establishes a floor for royalty valuations consisting of the higher of either a floor value determination predicated on the market for gas from the leases or the gross proceeds realized by the lessee upon sale of the production. Supron Energy Corp., [46 IBLA 181 (1980), appeal pending sub nom. Conoco v. Andrus, No. 80-0261-M (D.N.M. filed April 17, 1980).] However, we find the present case to be distinguishable. As appellants point out, in the present case a price falling below the floor value is raised not to the floor value, but to a price computed by averaging the floor value with the high spot market price, in effect making the average the floor value. We find that the acceptance of any settlement price within the range of the law to high spot market price as constituting fair market value is inconsistent with requiring payment of the average spot market price where lessee's settlement price is less than the floor value. While the obligation of MMS to value production at no less than the gross proceeds realized by the lessee may lead to a valuation in excess of the fair market value/floor value where this is reflective of proceeds received by the lessee, the fair market value is the standard at issue in this case where the NGLP were used internally and not marketed. If the average spot market price rather than the floor price constituted fair market value, then MMS would be without authority under the statute and regulation to accept royalty settlement prices as low as the floor price as the Procedure Paper indicates MMS has done. Accordingly, we are unable to affirm the application of the Procedure Paper to the extent it is used to value NGLP production at a price in excess of the fair market value floor price and, hence, must remand this case for recomputation of any additional royalty due and applicable late payment charges.

Id. at 243, 244.

Accordingly, we must similarly adhere to this qualification where the guidelines of the Procedure Paper have been used to value NGLP production at a price in excess of the fair market value floor price and, we must remand this case for recomputation of any additional royalty due and any applicable late payment charges.

We next consider the issue raised concerning the nature and the extent of the manufacturing allowance accepted by MMS for the Cow Island Complex for these two OCS leases. Mobil argues that the costs of compression, storage, loading, and movement of extracted products are necessary elements of the costs of processing. Mobil asserts that processing and extraction would eventually be curtailed and/or shut down, if the product was neither moved nor stored and consequently, expenses for these activities should have been allowed (SOR at 4, 5). MMS has responded that Mobil has not sub-stantiated its statements and has not shown error. It points out these costs were properly excluded from processing costs because these costs are incidental to marketing and the lessee is obligated to bear the costs of placing the production in marketable condition (MMS Response at 9).

When a Federal lessee refines gas for the recovery of constituent hydrocarbon products, it must pay royalty on either the value of the gas
before refining, or the value of residue gas and the products extracted by the refining process, whichever is higher. 30 CFR 206.152 (1986). In this case, Mobil, a Federal lessee, holds a 50-percent interest in the refinery where the gas is processed, and a manufacturing allowance is used by MMS to permit calculation of the royalty due on processed gas, so that the royalty computation required by 30 CFR 206.152 can be made. This manufacturing
allowance may not exceed two-thirds of the value of the liquids produced. Id. The allowance is limited to a reasonable allowance determined by the Director based upon regional plant practices, actual plant costs and other pertinent factors. 30 CFR 206.152(a). It is also subject to audit by MMS. The OIG audit of the Cow Island Complex for the two OCS leases in question led to the MMS findings now under review.

In calculating the manufacturing allowance for the Cow Island Complex, a formula was used by MMS. The components of the formula relevant here include liquid sales value, operating expenses, and depreciation. The formula is used to derive a factor representing the allowable deduction from royalty. MMS sets out the formula which divides the plant cost (the sum of the operating expenses, depreciation, and a profitability/taxability factor) by the liquid sales value. Mobil has not challenged this formula in this appeal. Moreover, this Board has recently accepted this formula at face value in similar circumstances where Mobil had also challenged the recalculation of royalty valuation claiming similar marketing allowances in Mobil Oil Corp., supra at 218.

[2, 3] As in that case, Mobil does, however, challenge the refusal by MMS to include certain costs and exclude some revenues when making computa-tions using the formula. Mobil maintains that certain costs of compression, storage, loading and movement of extracted products are integral parts of the extraction process and should be included in the cost of processing.

Such costs include the costs associated with the operation of the Riverside Dock Facility, the Napoleon Storage Facility and propane storage dome (SOR at 4).

Mobil does not substantiate this allegation nor does it show error in the MMS conclusion that these expenses are "incidental to marketing" for which no allowance shall be made under 30 CFR 206.152(d). Nor has Mobil provided any evidence with this appeal to overturn the general rule that a Federal lessee is obligated to bear the costs of putting oil or gas in marketable condition. Mobil Oil Corp., supra at 220; The California Co., 66 I.D. 54 (1959), aff'd, California Co. v. Udall, 296 F.2d 384 (D.C. Cir. 1961). Transportation and storage costs incurred after processing is com-plete may not be included as a factor in developing a manufacturing allowance. In such instances unless Mobil provides clear and persuasive evi-dence
that MMS is in error, it has not met its burden and its arguments must fail. Mobil Oil, supra at 222; Amoco Production Co., 85 IBLA 121, 129 (1985).

Mobil also argues that income on gross liquids (IGL) should be limited to the value of NGLP's in which Mobil has an economic interest. Mobil states that the plant processes gas produced from Mobil's interest in leases, as well as gas belonging to non-plant owners. Mobil retains, as a processing fee, a percentage of the NGLP's extracted from gas belonging to non-plant
owners. In calculating IGL, Mobil concedes it must include the value of 100 percent of Mobil's NGLP's and the value of that portion of non-plant owner
NGLP's retained as the processing fee. However, it maintains that only the percentage of liquids retained by Mobil in payment for refining should be included for royalty calculation, rather than all liquid values, as MMS contends.

The Board considered and rejected this same argument raised in Mobil Oil Corp., supra at 219, where MMS responded to Mobil's argument with the same analysis presented in this case as follows:

> The effect of Mobil's argument would be to use 100% of the plant costs (including operating expenses and depreciation) in the formula but only part of the gas for the processing of which those costs were incurred; in other words, Mobil's formulation allocates the entire plant cost only to the portion of the liquids which Mobil owns. The result is to ascribe to those liquids a higher cost of processing than what is actually incurred. The costs properly attributable to the non plant owner's gas which Mobil processes are covered by the 20% share of the gas which Mobil retains as its "fee" and on which no royalty is assessed. Thus Mobil's formulation artificially inflates the processing costs attributable to its gas and thereby artificially reduces the proper royalty due on the extracted liquids. * * * [A] manufacturing allowance based on all processing costs must also be based on * * * all liquid values.

(Answer at 11).

In rejecting Mobil's rationale, we stated:

> We agree that were MMS to allocate all the costs of operat-ing the plant against only part of the liquids produced by the plant it would distort the true cost of production of each unit of the substances produced. So limiting the revenues of the plant would inflate the cost to produce each unit of liquid considered, since only retained liquids would be considered to produce revenue. The costs incurred to refine gas for non-owner producers would however, continue to be included in total plant costs. This would inevitably reduce royalty, since it would decrease the apparent value of production from the plant by increasing the cost of manufacturing for all units produced.

Mobil Oil Corp., supra at 219.

We adhere to our position as stated in Mobil and find in the present case that Mobil has not shown how such a method of calculation would accurately depict the actual cost to produce a unit of liquid for purposes of calculating the plant manufacturing allowance. Mobil has failed to show how a formula used to calculate a manufacturing allowance which includes all processing costs can reasonably recognize only part of the liquid production obtained. Again it has failed to meet its burden to show error in the MMS conclusion so its argument must fail. See Amoco Production Co., 85 IBLA 121, 129 (1985).

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is set aside and remanded to MMS for further action consistent herewith.

John H. Kelly
Administrative Judge

I concur:

Bruce R. Harris
Administrative Judge